Agricultural Production and Credit Project (APCP)

A Final Assessment

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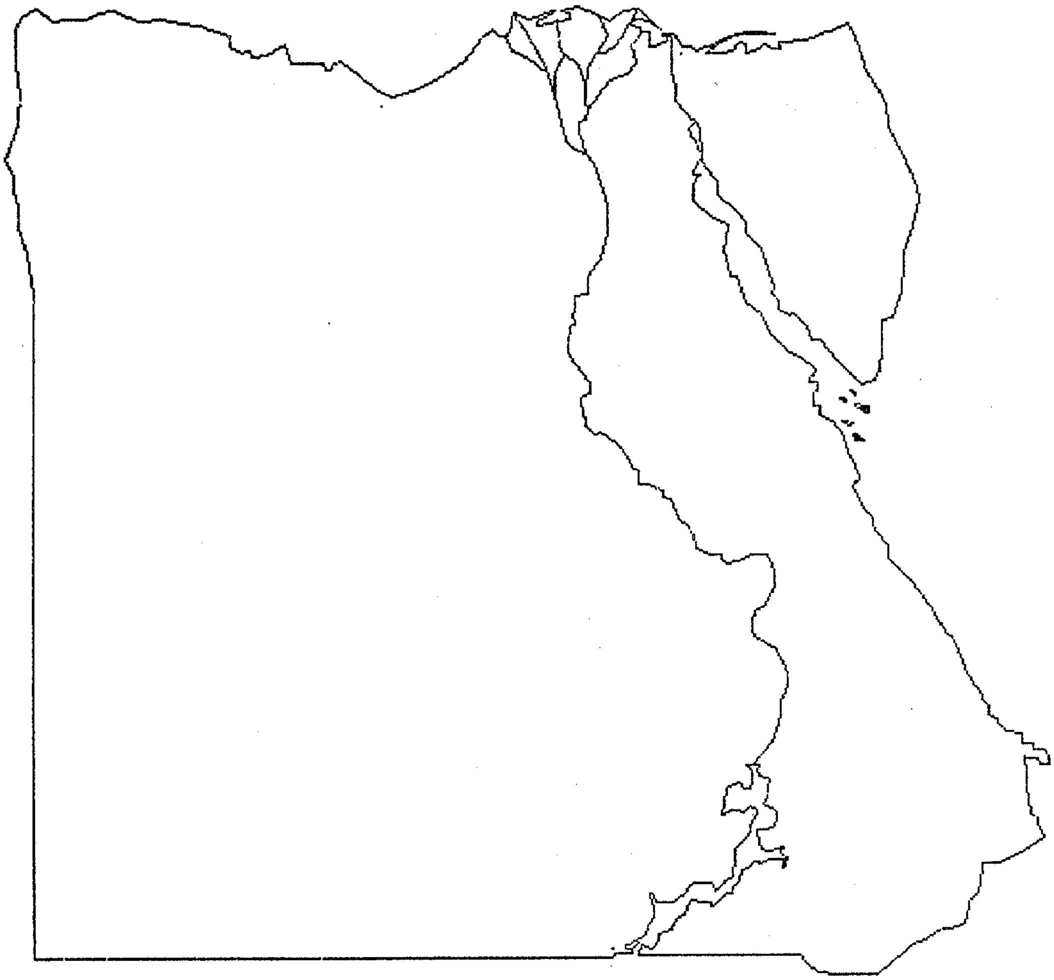

Presented to:

Cairo, Egypt

Prepared by: Lehman Fletcher and Karl Jensen

DATEX INC

7799 Leesburg Pike
Suite 1150, North Tower
Falls Church, VA 22043

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AGRICULTURAL PRODUCTION AND CREDIT PROJECT (APCP)

A FINAL ASSESSMENT

Prepared for: Ministry of Agriculture and Land Reclamation
U.S. Agency for International Development
Cairo, Egypt

DATEX, INC.
7799 Leesburg Pike
Suite 1150, North Tower
Falls Church, VA 22043-2413

Lehman B. Fletcher and Karl F. Jensen

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ACKNOWLEDGMENTS

To succeed in the intimidating task of assessing a ten-year project of the scope and magnitude of the Agricultural Production and Credit Project requires special conditions and circumstances. The staff of the funding agency must be willing to share their expert knowledge, participatory experiences and project records. Those in the MALR/GOE who created the vision of policy reforms and institutional improvement and carried the burden of formulating and advocating for the policy decisions and institutional changes must be willing to patiently revisit their wins, losses and draws. The managers and staff of the bank and the technical assistance experts must be willing to openly recount the complicated institutional and interpersonal interactions involved in effectively utilizing technical assistance personnel and resources to redirect a large and complex organization. All this and more was generously offered to us by USAID staff, Higher Policy Committee members, managers and personnel of the PBDAC, and Chemonics consultants. In return we have attempted to reach our conclusions and offer our recommendations with the same constructive and collegial spirit that was extended to us.

Lehman B. Fletcher
Karl F. Jensen

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Executive Summary

The Agricultural Production and Credit Project (APCP), which began in 1986, had two components: (1) a program assistance component that utilized cash transfers ($275 million) to encourage agricultural policy reforms and (2) a project assistance component ($34 million) to strengthen the Principal Bank for Development and Agricultural Credit (PBDAC). The two components were highly complementary. The policy reforms improved incentives for agricultural production and agribusiness operations while the project assistance helped divest the PBDAC of its input-distribution and marketing activities, thus creating opportunities for the private sector, and enhancing its new primary role as a rural financial institution. Moreover, since the PBDAC received local currency equivalents of the cash transfers as equity capital, it had strong motivation to work for timely and successful implementation of the agreed reforms.

The APCP quickly moved the agricultural sector to the forefront of Egyptian economic policy reforms, well ahead of macroeconomic and trade policy reforms under the government's Economic Reform and Structural Adjustment Program (ERSAP). The sweeping agricultural policy reforms under the APCP have substantially liberalized agricultural production, pricing and trade. While some policy reversals and setbacks occurred during 1995-96, the decade-long program has achieved a remarkable transformation of Egypt's agricultural policies. Future program assistance under the new Agricultural Policy Reform Program (APRP) will need to focus on improved services and institutional arrangements to address second-generation problems of market failures and performance.

Impressive progress toward the longer-term policy goals was made through a series of seven sets of tranche benchmarks. A report at the end of each tranche period verified whether or not the agreed policy benchmarks had been successfully achieved. The cash transfers were then made but adjusted downward from the planned amount according to USAID's evaluation of policy performance. Then negotiation of a new set of benchmarks restarted the tranche cycle.

The basic process was very effective. Negotiations for the MALR were handled by a Higher Policy Committee, appointed by the Minister. PBDAC representatives were very active given the importance of the capital grants to the Bank. The United States Agency for International Development (USAID) was represented by staff from its Directorates of Agriculture and Economic Analysis and Policy. Negotiations were frequent and intense, and supported by careful monitoring and verification of the tranche benchmarks. The continuity and depth of the policy dialogue, as well as collaboration on studies and policy formulation, were perhaps more important to the success of the policy reform component than the program assistance provided.

The policy reforms improved the performance of the sector in significant ways: production of major food crops and real farm income rose substantially. But liberalizing output and input markets also exposed farmers, processors and consumers to price instability in the international markets. Little has yet been done to develop a system for collection and dissemination of price and market outlook information. This system and other institutional arrangements to assist producers and consumers to adjust to external market shocks are needed.

Recent policy reversals and setbacks have damaged public confidence in the continuity of GOE policies and created uncertainty about the security of private investment and agribusiness operations. The GOE should give high priority to establishing its credibility so that private sector agents have confidence that its policies will not be suddenly reversed. Perceived market failures should be addressed only through limited interventions that disrupt private sector activity as little as possible.

With the broadening of the new reform program, continuing to treat studies and policy formulation as benchmarks and weighting all of a large number of benchmarks equally risks dissipating resources and diminishing the incentive effects of policy conditionality. An alternative approach that assigns conditional assistance in proportion to the expected impacts and strategic importance of the required policy actions should be developed.

Largely as a result of the additions to its equity capital under the APCP, the PBDAC's equity has risen from LE 100 million to LE 900 million. This has made an expansion in its loan portfolio possible. The PBDAC has, and will continue to have, a crucial role in supplying credit in rural Egypt. It is evolving from its previous role as a supplier of in-kind credit and provider of distribution and marketing services into a bank to provide credit and financial services to Egypt's small farmers, agricultural businesses, and, increasingly, to the entire rural community. While finding this transformation as yet incomplete, this assessment supports PBDAC's continued transition toward a status as a viable financial institution for finance and credit for all of rural Egypt.

The Bank Improvement Program, which was initiated only in the last two years of the project, has is moving in very promising directions for the future of the village and branch banks and the BDACs. It has successfully tested credit-worthy lending methods, promoted deposit mobilization, and extended lending to women and non-farm businesses, which clearly shows that these changes are possible and productive. This approach should be extended system-wide, and would benefit from additional donor assistance to further improve the bank's incentive system, loan performance appraisal and reporting, and training of staff.

Considerable progress in establishing a computer-based management information system has been achieved. It has emphasized accounting, payrolls and deposits. Loan performance data have been neglected and should now be emphasized, including modern measures of loan performance such as portfolio at risk. Data flowing upward should be matched by return flows of information on comparative performance for use in the lower-level units.

As shown by its recent forced forays into cotton marketing and fertilizer distribution, the PBDAC has not yet completely succeeded in changing its image within the MALR and the GOE to that of a broad and autonomous financial institution serving rural Egypt. Complete divestiture of staff and facilities in excess of its needs as a bank would assist it to make that transition as well as clean its books so that its costs and returns for finance and credit would better reflect its true profitability. It can operate as a development bank as long as the costs of unprofitable services and loans are covered by outside grant funds and PBDAC has autonomy in borrower selection, interests rates for deposits and loans, credit supervision and loan collection for its regular clientele and for all types of businesses it finances.

For long-range viability as a rural financial institution, the PBDAC needs a further expansion of staff experienced in modern banking techniques, a reduction in the number of BDACs and a reorganization of its management to establish separate roles for the chairman and a Chief Executive Officer of the Bank.

All conclusions and recommendations mentioned in this summary are developed in detail in the text of the Assessment. The recommendations are also extracted and summarized in the final section of the report.

Final Assessment
Agricultural Production and Credit Project
(APCP)

1.0 Introduction and Purpose

The Agricultural Production and Credit Project (APCP) has been a leading and innovative element in U. S. Agency for International Development (USAID) support of economic policy reforms in Egypt. It assisted an important sector of the economy, a sector seriously burdened by pervasive policy repression and government regulation in the pre-reform socialist period. That strong policy discrimination against agriculture reduced the rate of agricultural growth, lowered farm income and inhibited improvements in agricultural productivity. The result was that the agricultural sector faltered and failed to achieve the output, export and income contributions required for rapid and sustainable growth of the overall economy.

The APCP, which began in 1986, quickly moved the agricultural sector to the forefront of Egyptian policy reforms. Gradual macroeconomic reforms were also attempted from 1987 onwards but their success was undercut by political and social constraints and external shocks to the economy. A major new program of policies for economic stabilization and structural adjustment (ERSAP) was adopted by the Government of Egypt (GOE) in 1991, supported by donor debt relief, International Monetary Fund (IMF) and World Bank assistance, and cash transfers under USAID's Sector Policy Reform programs (SPR). Since withdrawal of IMF and World Bank programs in 1994, SPR has been the only continuing donor support for Egypt's economy-wide policy reforms. However, visits from Fund Bank teams and a meeting of the Paris Club will review progress toward macroeconomic reforms and may soon result in a resumption of concessional lending and additional external debt reduction.

APCP had two components: (1) a program assistance policy reform component that utilized cash transfers ($275 million) to encourage agricultural policy reforms, and (2) a project assistance institutional strengthening component ($34 million) to support the transformation of the Principal Bank for Development and Agricultural Credit (PBDAC) from a supplier of in-kind credit and distributor of subsidized inputs to a viable rural financial institution. This assessment, coming near the completion date of the project in September 1996, was planned to review progress in both the policy reform and institutional strengthening components, to identify the interactions between them, and to recommend directions for further policy reforms and PBDAC development. Its conclusions emphasize the synergy created by the unique combination of program and project assistance in the APCP, and recognize the intensity and depth of the policy dialogue and collaboration between the Ministry of Agriculture and Land Reclamation (MALR) and USAID.

The sweeping agricultural policy reforms associated with the APCP have dramatically altered the policy environment in the agricultural sector. Compared to the pre-reform period, Egyptian farmers are now much more free to choose what, how, and how much to produce. Inputs are more often purchased from private suppliers and products more often sold to private buyers at market-determined prices that are themselves more closely aligned to international levels. While some policy reversals and setbacks during 1995-96, which are discussed in Section IV, created controversy in the policy dialogue and delayed completion of the final phase of the APCP, an overview of the entire period clearly confirms that the decade-long program has achieved a remarkable transformation in Egypt's agricultural policies. Perceived problems of market imperfections and instability are now creating growing concern over needed institutional improvements to make markets work better. These second-generation problems of market failures and performance, largely untouched by the APCP reforms, will require much more attention under the new Agricultural Policy Reform Program (APRP). Similarly, continuing problems with real exchange rate appreciation, which erodes agricultural production incentives and export competitiveness, and high industrial trade protection, which maintains bias in the domestic terms of trade against agriculture, create a critical linkage between needs for further agricultural policy reforms and for more rapid macroeconomic and trade policy reforms.

2.0 Historical Background of the APCP

The higher goal of the APCP was "to increase agricultural investment, agricultural productivity and farm incomes in Egypt". The original project purpose chosen to operationalize that goal was:

> To provide farmers with new technology, improved financial services and expanded access to input supply so that they can take advantage of higher returns to investment in a deregulated agricultural sector.

In the pre-reform period, PBDAC lending was mainly in-kind rather than in cash. Credit was extended as an in-kind allotment of seeds, fertilizers and chemicals based on the government prescribed cropping pattern for each geographic area (block) at specified rates of input application. Most inputs were subsidized, which encouraged farmers to use them in excessive amounts or sell them on the black market. Most products were delivered under mandatory quotas to the PBDAC or the village cooperatives at low fixed prices. Since the value of the in-kind loans were subtracted by the PBDAC from payments for products, loan repayment rates for the in-kind credit were high.

Policy reforms were included in the original project purpose only by the somewhat cryptic reference to "a deregulated agricultural sector." Political sensitivities at the time made it imprudent to explicitly identify policy reforms as a major purpose of the project. After several modifications, the purpose was changed to include "to assist the GOE to make policy changes to deregulate the sector". The revised purpose also explicitly included a redirection of the PBDAC to offer full banking services based on market interest rates and rapid and efficient loan approval. The purpose continued, however, to contemplate a linkage of improved financial services with increased extension services to farmers and expanded access to input supply.

These modifications established several end-of-project conditions for the PBDAC:

(1) a stronger capital structure and capital management system;

(2) effective management controls based on budgeting, auditing and financial analysis of bank performance;

(3) a responsive personnel management and training program; and

(4) a modern management information/accounting system.

An increase in private-sector participation in agricultural input supply and services was also established as an end-of-project outcome.

While these changes did explicitly recognize policy reform as a purpose, they did not state end-of-project conditions for the reform component nor clarify whether the reforms were regarded as means or as ends in themselves. In reality, policy reforms are means, not ends. They are expected to contribute to medium and long-term objectives of sector and overall national economic growth and development. In Egypt in the pre-reform period, agricultural output growth was inadequate for the consumption and export needs of the country, and rural households were too poor to create much demand for industrial production and consumption goods. The intent of the reforms was to encourage more productive and efficient use of land and water resources and purchased inputs, raise output and employment growth in the sector, and increase rural incomes and food security of the poor. These are the long term results against which the APCP policy reform accomplishments should be assessed.

3.0 APCP's Approach to Sector Assistance

Most of the resources under APCP have been disbursed as performance-based program assistance. Cash transfers have periodically provided US dollars to the GOE, initially for balance-of-payments support and in later years to finance US commodity imports. The local currency equivalents of the cash transfers were required to be assigned by the GOE to the PBDAC as increases in the Bank's equity capital. This approach is generally consistent with the recent USAID policy paper on program assistance, which defines and authorizes sector program assistance.[1] The policy states that in this form of program aid "uses of local currency must assist in attaining the proposed development objectives at the sectoral level in an identifiable and measurable way."[2] The capital grants of local currency to the PBDAC were designed to strengthen its equity base, seriously eroded by numerous

[1]USAID. Policy Paper on Program Assistance, Washington: Bureau for Program and Policy Coordination, February 1996.

[2]Ibid. p. 10.

subsidized credit schemes, and help it adjust to divestiture of its profitable input distribution activities. How local currency use under the new Agricultural Policy Reform Program (APRP) will conform to the Agency's current policy guidance on sectoral program aid has not yet been made clear.

The institutional strengthening component of APCP has been almost totally directed to the PBDAC, with only some earlier assistance provided to MALR extension (e.g., in-service training). It has provided technical assistance, training and equipment to help divest the PBDAC of its input distribution activities and transform it to a viable rural financial institution serving farmers and rural enterprises. That component will be evaluated in depth later in this report.

The complementarity of the two components was one of the most successful aspects of the APCP approach. The policy reforms freed farmers from crop quotas, liberalized product markets and moved input distribution into the private sector. The project assistance helped enhance the PBDAC as a supplier of credit for agricultural and rural borrowers and adjust it to its new primary role as a rural financial institution. **The total intended effect of the APCP as a whole was to improve incentives for agricultural production and agribusiness activity as well as to expand credit to support** private sector responses to the improved production incentives and expanded agribusiness investment opportunities.

The synergistic relationship, however, even went beyond the mutual complementarity of the two components. The PBDAC was placed in a central role in both components. Since it was to receive the local currency equivalents of the cash disbursements as equity capital, the PBDAC had strong motivation to assure that policy conditions for each of the tranche disbursements were fulfilled. While the MALR was officially represented by a multi-member policy committee, it was the PBDAC that had the most direct interest in timely implementation of the agreed reforms. How to replicate these institutional incentives within the APRP is an important issue and a more complex one since several ministries are participating in the new policy program.

The original design and approach called for PBDAC to serve as a conduit for technology transfer to farmers by linking extension services and credit. This approach was expected to extend efforts under the previous USAID-funded Small Farmer Production Project (SFPP) in which unsubsidized lending was supervised jointly by PBDAC credit officers, farm management specialists and MALR extension staff to guide farmers to adopt profitable new technology and use inputs efficiently. The original APCP concept was to extend this supervised and package lending throughout rural Egypt. Difficulties in assembling tested technological packages, coordinating with extension and gaining farmer confidence in discretionary recommendations from government officials who previously gave orders, undercut implementation of this approach. As understanding of the necessity and opportunity to transform the PBDAC into a viable rural financial institution emerged, interest in supervised and package lending receded and the approach was dropped. Egypt badly needs an effective extension capacity to encourage the adoption of new agricultural technology and optimal use of scarce land and water resources and purchased inputs by its millions of small farmers.

However, as a bank the PBDAC should be supportive of, but not a formal part of, that technology transfer system. The need to coordinate technology transfer and credit is real but PBDAC credit officers should not themselves provide technical advice nor require adoption of specific technical packages as a condition for loan approval. As discussed later, the PBDAC should be much more concerned with the creditworthiness of its borrowers and the expected profitability of the intended uses of its loans. The extent and future of the PBDAC's transformation to this type of lending is assessed in Section 5.0.

RECOMMENDATION: USAID and the GOE should consider how new sectoral program assistance can be utilized effectively within a multi-ministerial framework such th 'he allocation of local currency will both create incentives for, and support ministerial policy decision-makers in, implementing priority reforms, and also encourage sectoral capacity-building and institutional improvements in a sustainable manner.

RECOMMENDATION: The MALR should identify and implement innovative approaches to improve the capacity of Egypt's extension system to effectively deliver research-based technological and managerial information to all of Egypt's farmers, involving the private agribusiness sector to the fullest extent possible. The PBDAC should coordinate its agricultural and rural lending with the flow of information but should have no operational responsibility for actual delivery of technical recommendations or educational services.

4.0 The Policy Reform Component of the APCP

4.1 Introduction: Approach and Process

This component began in September 1986 when an agreement was signed that provided for disbursement in tranches of cash transfers to the GOE conditional on implementation of mutually agreed policy reforms by the MALR and the USAID. The medium and long-term goals established initially for the reforms were the following:

- phase out farm price controls,
- relax government crop area controls,
- cancel government crop procurement quotas,
- liberalize government constraints on private sector marketing and processing of farm products and inputs,
- reduce subsidies on farm inputs, and
- limit state ownership of land.

Specific policy actions in support of these longer-term objectives were negotiated at the beginning of each sequential tranche period. A report at the end of a period verified whether or not the agreed policy benchmarks had been successfully achieved. The cash transfers followed, but the full tranche payment was made only if the benchmarks were achieved to the satisfaction of the USAID.

Otherwise, a reduced cash transfer was made. Then negotiation of a new set of benchmarks would restart the tranche cycle.

This pattern of interaction between the MALR and the USAID was maintained throughout the APCP period. The MALR was officially represented by a multi-member policy committee designated by the Minister. The USAID was represented by staff from its Directorates of Agriculture and Economic Analysis and Policy. For reasons explained earlier, negotiations on the Ministry side were often handled mainly by policy committee members representing the PBDAC. Nevertheless, the tranche agreements and the tranche verification reports were approved by the entire committee membership. Contacts between the USAID and the committee were frequent. Negotiations were always long and intense and occasionally somewhat disputatious. Neither side was reluctant to refer contentious issues up to the Minister/Mission Director levels for resolution.

The second phase (1990-96) of the APCP policy reform component sharpened the policy focus and developed more quantifiable policy targets. The medium and long-term policy objectives were:

- increase cotton procurement prices to 66 percent of the border price but changed to complete cotton price liberalization in 1992),
- eliminate rice quotas,
- eliminate subsidies on all inputs,
- reduce the PBDAC's role in input marketing,
- restrict subsidized credit,
- improve PBDACs organizational structure and operations, and
- reform the structure of seed production and marketing.

Impressive progress toward achieving these longer-term objectives was made through a series of four sets of tranche benchmarks. The final Tranche VII will be completed in July 1996. Review of the lists of longer-term goals for the two phases of the APCP policy reforms shows that the initial focus was on farm-level interventions within the sector, most of which could be addressed with relatively little involvement of other ministries and higher levels of policy decision-making. During the second phase, the greater emphasis on liberalizing agricultural markets and lowering border-price distortions on products and inputs increasingly affected other ministries and a wide array of state-owned agribusiness companies and trading organizations. It was therefore necessary to negotiate reforms with policy decision makers outside the MALR and resolve conflicts at the highest levels of government authority and legislative power. The growing need to involve policy makers outside the MALR slowed the pace of the reforms and placed a greater burden on MALR officials to seek political support and consensus outside the sector.

The basic process of specifying longer-term policy goals and then agreeing on specific policy reforms needed to achieve those goals was very sound. Moreover, it was continuously supported by careful monitoring and verification of the tranche benchmarks. This pattern was fully established by the end of the Tranche III in 1989 and was continued through the final Tranche VII in 1996.

RECOMMENDATION: The process of establishing longer-term policy goals and then identifying specific policy actions to reach those goals through sequential tranche agreements has been very effective. The MALR was well represented by its higher policy committee, although the PBDAC representatives were usually the most active participants. USAID staff not only engaged in intensive tranche negotiations and performance reviews but also contributed greatly to the policy analysis and formulation efforts. This pattern of interaction and close collaboration should be maintained in future USAID sectoral program assistance for policy reforms. The sharing of ideas and experience, and mutual search for appropriate policy approaches and actions, has been, and will continue to be, as important to the success of the reforms as the monetary assistance provided.

4.2 Nature and Accomplishments of the Reforms, 1987-96

Before the reforms began at the end of 1986, the government closely controlled and regulated the agricultural sector. Major crops were under an administered marketing and pricing system based on crop quotas and fixed prices. Prices of most inputs were set by the government and delivered by the PBDAC and cooperatives at subsidized prices. Most agricultural imports and exports were controlled by government agencies and state owned enterprises. The PBDAC provided in-kind credit at below-market interest rates. Commodity imports by the PBDAC at the official overvalued exchange rate lowered domestic farm-gate prices.

During the reform period, most government controls within the agricultural sector have been eliminated. Prices of crop and livestock products and inputs are now determined, for the most part, through market forces. The government no longer enforces a crop rotation plan in each geographic area; controls on cotton varieties by zone, restrictions on rice areas, and mandatory sugar cane production are the main remaining controls. Sugarcane is the only crop still sold solely to the government. A summary of the major reforms through 1994 is given in Table IV.1, which also describes the policy environment in the pre-reform 1981-86 period.

The final Tranche VII of the APCP policy reform component was negotiated in 1994 and scheduled for completion in 1995. This tranche concentrated on liberalization of cotton pricing and marketing, ex-factory fertilizer prices, and continued strengthening of the PBDAC, which had been brought into the tranche benchmarks to speed its organizational and performance improvements in recognition of the large additions to its capital it was receiving. Other benchmarks involved import bans on red meat and poultry, tariffs on imported tractors, and privatization of seed production and distribution. Progress in this tranche was slow and set back by policy reversals discussed later in this subsection. The MALR requested and was granted a delay until 1996 to complete this tranche, and finally submitted a Tranche VII monitoring and verification report in April 1996. USAID evaluated the overall performance as poor and proposed a cash transfer of only about 60 percent of the scheduled amount. Final negotiations were taking place at the time of this assessment to end the tranche in July 1996 and to make some additional cash transfer for policy decisions and actions taken during March-June.

Table 4.1

Agricultural policies, 1981-86, and policy reforms, 1987-94.

Crop/Policy	1981-1986	1987-1994
A. Minor crops	• Eight minor crops were affected by various degrees of quotas, price controls, marketing controls, input subsidies, exchange rate overvaluation and trade controls during 1981-86. These crops were broad beans, lentils, sesame, groundnuts, onions, garlic, soybeans and potatoes. • Neither acreage restrictions nor delivery quotas were applied to these eight crops during 1981-86. Government procurement prices were in effect but delivery was not obligatory. Intergovernmental transport was restricted and would have had some impact on geographical price patterns and efficiency of distribution by areas.	• All crop area, quota, and price restrictions were eliminated by 1987, except that floor prices were introduced. Marketing restrictions were eliminated in 1987, except for rice, cotton and sugarcane.
B. Wheat and maize	• Area restrictions were imposed on wheat but not maize. Quota and fixed procurement price applied but only nominally to maize and to less than 10% of wheat procured. Real farm-gate prices increased 52% for wheat and 45% for maize from 1981 to 1986. Farm-gate prices averaged 85% of world price for maize and 80% for wheat, from 1984 to 1986. • Marketing, processing and imports were controlled by the government.	• Area restrictions, quotas and fixed procurement prices were removed for wheat and maize, in March 1987. Marketing and processing were controlled for approximately 50% of production by public sector firms. Consumer subsidies on bread depressed farm prices, as did subsidies on maize to feed manufacturers. Private sector was allowed to import maize in 1991. Private wheat flour imports were allowed in 1992. Wheat prices increased between 1987 and 1992.
C. Rice	• The full range of controls (procurement quotas) and fixed procurement control of marketing, processing and exports applied throughout the period. Over 50% of milling capacity was owned by the government. There was no transport or export by private sector. • Official prices increased 94% over this period; average farm price increased 150%. • Government procured 48% of production. • Weighted average market price was 45% of world price between 1981 and 1984.	• Area was still controlled for antisalination and water allocation purposes. • Procurement quota was eliminated for the 1991 crop. Prices from 1987-1990 were between 75 and 90% of world price. During 1991 market prices remained at 82-89% of world prices. • All controls on price procurement, marketing and exports were removed in 1991. • Rice milling capacity was still over 50% publicly owned. • Strong political pressure was exerted to reduce rice area by 30% in 1987, and 13.3% more in 1988. Acreage was stable at about 1.1 mil. feddans 1989-93. • Consumer subsidy was high and was removed in April 1993. • Domestic market restrictions on private trade were removed in 1991 and 1992.
D. Cotton	• Strict acreage controls were enforced by fines; 100% quota delivery of fixed prices at less than 50% of the border price equivalent; prohibition of transport, ginning, domestic trade and foreign trade by private sector; and strict cropping pattern controls by region and by variety of cotton. • Procurement prices averaged 52% of border prices during the period and fell to 40% during 1987-1990.	• 1981-1986 policies continued as constraints through 1991, except procurement price was gradually increased to approximately 75% of the 1991 border price. • Procurement price was 114% of border price in 1992 and 132% in 1993, priced at market exchange rates. • Acreage controls were removed for the 1992 and 1993 crop. • All marketing restrictions and quota requirements remained the same. The marketing of cotton was liberalized in 1994.

E. Input prices, distribution and subsidies	• Fertilizer subsidy averaged about 50% in 1981-86 and 24% in 1987-88. • Fertilizer subsidies were over 50% and pest control subsidies were 100% for cotton. • All fertilizer was distributed by the PBDAC. Credit was tied to subsidized fertilizer purchases. • No explicit water charges. Implicit water subsidy was approximately double for rice compared with other crops. • Imported yellow maize was subsidized to feed mills. • Prior to 1985, most newly reclaimed land was allocated to public enterprises.	• Input subsidies of 50-60% applied to minor crops, although the link between fertilizer distribution subsidies and credit allocation may have distorted the pattern of subsidy actually received by farmers, as the PBDAC distributed fertilizer by providing credit in kind, which credit was allocated according to priorities set on a crop basis. • General fertilizer subsidy was increased 13% in 1986-1988 and declined to zero in 1992. • In 1985-1988, land reclamation programs were allocated almost 100% to private individuals. • Ex-factory prices of fertilizer reached 105-112% of border prices. • Cotton fertilizer subsidy was removed by 1991. • Cotton pest control subsidy was reduced by 25% in 1992, further reduced for 1993, and removed for the 1994 crops.
F. Exchange rate and trade policies	• Wheat and maize were imported by the GOE only. There were import subsidies and consumer subsidies. • Exchange rate was highly overvalued, depressing farm-gate prices relative to import prices and favoring imports over exports. • Exchange rate overvaluation caused LE 555 mil. transfer out of agriculture during this time. • No private rice exports were allowed. • Cotton, both for export and for domestic mills, was traded at administered prices by the public sector only. • Cotton was exported only at the official rate. Mill prices, for example, during 1981/2-1986/7 for Giza 75 were virtually identical to the farm-gate price. Thus, mills were subsidized by the amount of domestic ginning and marketing, and procured raw materials at the depressed farm-gate price of about 50% of the export prices. • The market exchange rate increased from LE 0.90/$ in 1981 to 2.30/$ in 1991, while the official exchange rate remained constant at LE 0.70/$. • The policy of taxing farmers through low procurement prices was enforced by fixed prices and monopoly marketing through the public trading companies.	• The GOE adjusted the official exchange rate from LE 0.70 in 1988 to 3.35 in 1991, while the market rate increased from LE 2.30/$ to LE 3.35/$ in 1991. The rate was freed in 1991. • The subsidy on maize was decreased by 81% in 1986-88. The private sector was allowed to process domestic and imported wheat. • Real wheat prices increased less than 2% in 1987-92. Real corn prices declined 25%. • The fertilizer subsidy was 24% until 1988 and was eliminated in 1992. • Field level costs were paid by farmers only on new lands. • Implicit subsidies on maize and wheat imports were caused by overvaluation of the exchange rate, eliminated in 1991. Bias was extreme and in favor of imports of wheat and corn during 1987-89 and against major export crops, including cotton, fruits, vegetables and rice. • 1990 domestic prices were close to border prices for both wheat and maize. • An import subsidy (U.S., E.U.) of about 20% affected both grains during the entire period. • The consumer subsidy for wheat and bread was continued. • The subsidy on wheat bran was reduced by 50% in 1991 and to zero in 1992. • Minimum export prices were set in 1991 but eliminated in 1992. Rice exports were opened to the private sector in 1991. • Cotton exports were made at the official rate, the official asking price was much higher than the true border price, and the procurement price therefore did not fully reflect the overvalued exchange rate. Procurement prices would have been less than 20-30% of the true border price if the full impact of exchange rate overvaluation had been passed to farmers.

Source: Compiled by authors from various documents of the Ministry of Agriculture and Land Reclamation and the United States Agency for International Development, Cairo.

Source: Table 4.8 in Chapter 4 of Lehman B. Fletcher, ed, ***Egypt's Agriculture in a Reform Era***. Ames: Iowa State University Press, 1996, pp. 63-4.

Overall, the policy reforms have improved the performance of the sector in significant ways.[3] Production of major food crops has increased substantially and real farm income has risen significantly. With few exceptions most direct controls and price interventions within the sector itself have been ended. While clear positive impacts of the reforms are evident, it is nevertheless premature to conclude that nothing is left to be done to improve policies affecting the sector. Moreover, much remains to be done to enhance the macroeconomic and trade policy environment in which the sector operates; provide effective public services to make agricultural markets work better; and encourage private investment, efficiency and competition in the agricultural input supply, processing, marketing, food distribution and trade industries. The APRP expands the policy agenda into these important areas.

An important unresolved issue in direct sector policies can be diagnosed using Figure 4.1. This figure exhibits the valuation of agricultural resource income generated annually by 11 major crops in the old land area of the Nile Valley and Delta. This measure proxies value-added for the crops included, which corresponds to the total income generated for the land, water, labor and capital resources allocated to their production.

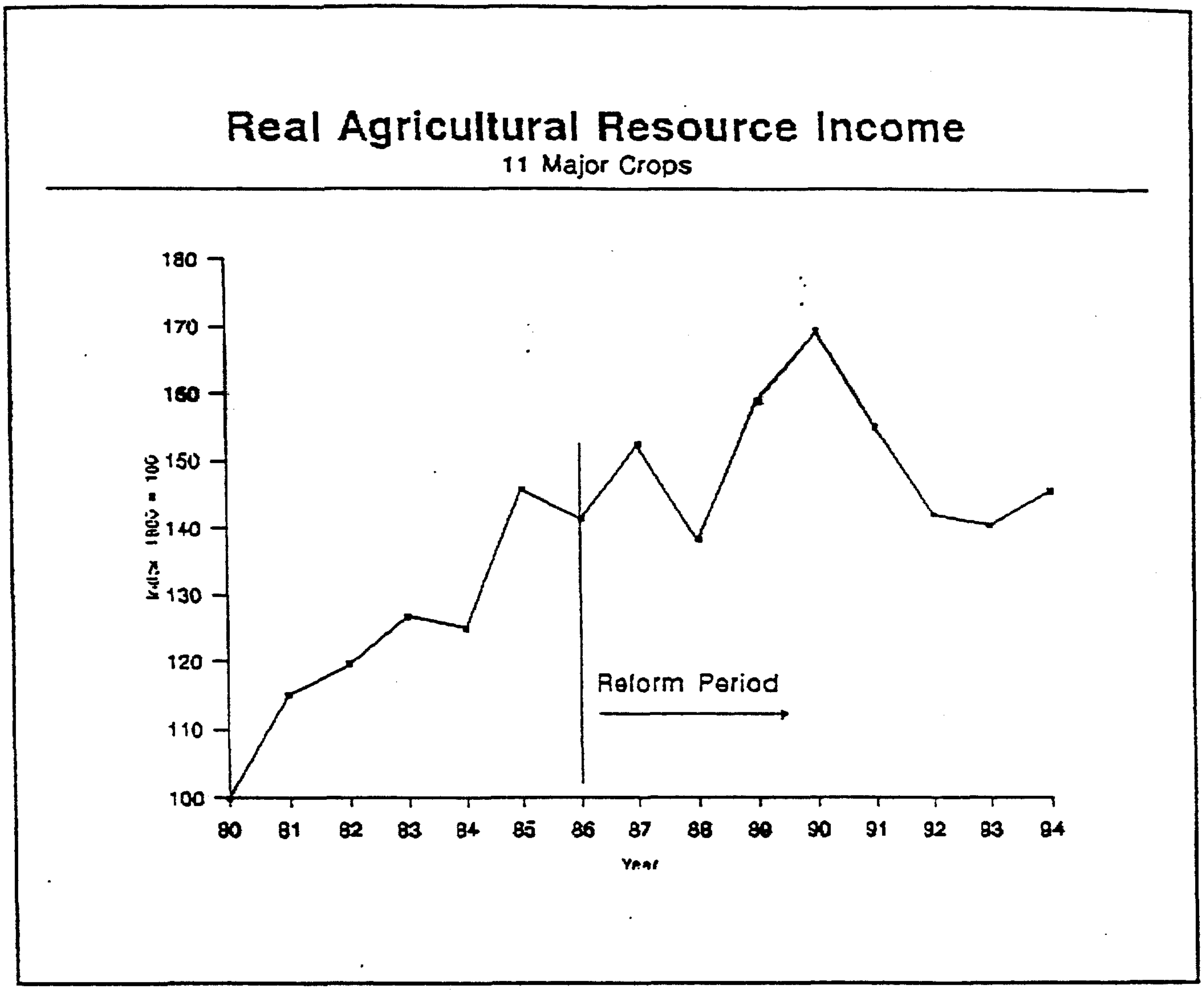
The measure, deflated by the implicit GDP deflator, averaged LE 4.7 billion annually during the 1981-86 pre-reform period. It rose to an average of LE 6.1 billion annually in the early reform years, 1987-90, an increase of 30 percent. Then agricultural resource income suffered strong declines in both 1991 and 1992. A more modest decline followed in 1993 before the real resource income measure turned upward again in 1994.

Two factors accounted for much of the 1991-93 fall in real agricultural resource income. First, international prices for the important wheat, maize, rice and cotton crops declined. To the extent those lower border prices were transmitted to domestic farm-gate prices, farm income fell. Second, real costs for purchased inputs rose as subsidies on fertilizers chemicals, fuels and other inputs were lowered or removed entirely. The income increase recorded in 1994 primarily reflects higher international grain and cotton prices, a pattern that persisted even more acutely in 1995 and 1996.

Liberalizing Egypt's agricultural output and input markets has thus exposed its domestic markets more fully to price instability in international markets. This means more uncertainty and greater price risks for Egyptian producers and consumers. All studies of agricultural markets in the reform era have identified a need for more timely and accurate information on prices and market outlook. Yet little has been done so far to create the public services and market institutions needed for efficient price discovery in domestic markets and to intermediate effectively between international and domestic markets. This omission suggests a possible error

[3] This assessment does not attempt to identify all the impacts of the reforms. A recent and comprehensive analysis of their impacts is available in Lehman B. Fletcher, ed. Egypt's Agriculture in a Reform Era. Ames: Iowa State University Press, 1996.

Figure 4.1



Source: Calculated by USAID/AGR/ACE staff using MALR data.

in the sequencing of the reforms.[4] Earlier attention was warranted to the development of a system for collecting and disseminating price and market information. There is a strong public interest in information that is credible, timely and accessible to all market participants as a means to perfect the operation of the market pricing mechanism. This need has been largely neglected so far in the reform period.

Beyond market information, a systematic study of the price fluctuations that can be expected in international commodity markets is needed. These fluctuations should be evaluated for their anticipated welfare losses by Egyptian farmers and food consumers from the income and expenditure variability they will create. Then cost-effective policy options that assist producers and consumers to adjust to external price instability should be formulated and implemented. More attention should have been given to the necessity for designing such new institutional arrangements during the first decade of the reform era.

Two events during 1994-95 have caused some concerns over the government commitment to sustained reforms. One involved cotton and the other the distribution of fertilizers. During the 1995/96 cotton marketing system, the government intervened at one point to suspend sales of seed and ginned cotton. The motivation apparently was to reduce prices of local cotton for the state owned spinning mills. Before this intervention cotton farmers were receiving prices very close to border levels, and well above the floor prices announced earlier by the MALR. This intervention reflected the political importance of the large state-owned cotton textile enterprises and the power of the government ministries representing those interests in policy decision-making. These enterprises have been accustomed to receiving lint cotton at prices lower than the value of long-staple cotton in international markets and providing low-priced cloth for domestic consumption. They will continue to protect their interests in cheap supplies of local cotton until they are assured of the availability of lower-priced imports of short-staple cotton. Once those imports are freed up, subject only to whatever phytosanitary controls are actually needed, and private traders are free to export cotton, seed cotton prices should again align themselves with international prices.

That a system for private trading and liberalized market pricing of cotton has not yet fully emerged is not a surprise and not proof of poor performance on the part of the MALR. For many years, cotton was completely controlled and dominated by the government. Even after the MALR became committed to liberalizing cotton marketing and prices in 1992, powerful interests of state trading organizations and textile companies had to be reconciled to the new policies. Some confusion has also been created by untimely producer price announcements, unclear floor-pricing policies and

[4] The error came in the actual sequencing of the reform, not in the planned sequencing. A separate project was developed and implemented in the early 1990s to strengthen the data gathering and dissemination activities of the MALR, including crop and price reporting and market outlook, as well as create a capacity for policy analysis. That project failed and was canceled. When that avenue came to a dead end, then more attention to institutional support and services for markets was needed in APCP itself rather than proceeding with price and market liberalization without the required institutional development and services.

inopportune operation of seed cotton marketing by the PBDAC, as well as the inappropriate price intervention by the GOE mentioned earlier. A tranche benchmark required that a spot market in cotton be reopened with neither a clear understanding of how it would function nor how needed price information would be collected and disseminated. While all of these issues need attention, and progress on some of them is expected in the near future, neither of the parties in the policy reform process should lose sight of the gains that have already been made in liberalizing cotton production and marketing in Egypt.

The second event was the setback to fertilizer policy reforms in 1995. By 1994, wholesale and retail distribution of fertilizer was almost wholly in the hands of the private sector. Domestic supply shortages developed in 1995. Evidence points to the holding of domestic prices of nitrogen below rising international prices, which created incentives for the state-owned fertilizer factories to export, as the reason for short supplies and rising prices. Factories were then instructed to withhold deliveries to private distributors and PBDAC was brought back as the sole distributor of domestically produced fertilizers.

The abrupt reinsertion of the PBDAC in the fertilizer distribution system was a severe blow to private distributors and created uncertainty about the security of private sector entry and investment in any type of agribusiness activity. This loss of credibility in GOE encouragement of the private agribusiness sector is probably the most serious consequence of the decision to return PBDAC to its role as fertilizer distributor, from which it is scheduled to exit again in mid-1996. The PBDAC, of course, can only carry out such orders from the government as long as it retains the necessary personnel and physical facilities. Transferring that capability from the PBDAC to another public sector organization would make it impossible for the PBDAC to take on such roles as organizing seed cotton marketing or distributing fertilizer on a national scale. While such divestiture through transfer would not in itself solve problems of excess public employment and unneeded facilities, those problems would become MALR/GOE problems and not further impede the transformation of the PBDAC to a profit-oriented financial institution, a transformation that is assessed in Section V of this report.

Some of the ultimate responsibility for the recent fertilizer fracas lies with pricing policies. Several tranche monitoring reports since 1990 have noted the high degree of variability in international fertilizer prices. The policy benchmarks have shifted (correctly) to border prices as the appropriate pricing standard, but have not been clear that export parity (i.e., fob Egypt) is the appropriate reference price for nitrogen fertilizers, nor about what adjustments are needed intra-annually in ex-factory prices in response to variations in international prices. The basis for the use of export parity border prices is that they represent the opportunity costs for using nitrogen fertilizer domestically rather than exporting it, and that farmers should pay those prices. That those are also the socially optimum prices for the state factories is not obvious if the factories are also receiving large fuel and power subsidies. Such subsidies create economic rents in the domestic production of exportable fertilizers. If some of these rents are not passed on to the domestic users of fertilizer (farmers) or are not taxed, then they accrue as inefficiency costs or excess profits to the fertilizer factories.

In 1995 international prices rose above the fixed ex-factory prices. Factories then had incentives to shift fertilizer from the domestic market to exports. The result was to create a shortage in the domestic market at the critical time for fertilizing summer crops. It is important to remember, however, that since domestic production was seasonally complete and shipping lags make it infeasible to import additional supplies, permitting domestic prices to rise would not have solved the shortage in the short run. The higher prices would only have rationed the available quantities to the larger and richer farmers more able to pay them. Allocating the limited and inelastic supply to all users administratively was certainly more equitable, although undoubtedly disruptive and corruptive as well. However, there was little justification for maintaining PBDAC's distribution past the period in which additional domestic production or imports could have normalized domestic supplies. PBDAC's entry to ration scarce fertilizer more equitably should have been joined to actions to free up imports, to lower incentives for factories to export and to promptly withdraw public distribution in favor of the private sector.

Current prices do not act as output signals for large monopolistic enterprises that must produce in advance to meet seasonal demands in the future. The information contained in international prices is about opportunity costs for the country and needs to conserve on domestic utilization when international prices are high. A strong case can be made that Egyptian farmers should pay prices equal to the long-term export value of the fertilizer they use. That does not necessarily mean domestic prices moving up and down on a daily, weekly, monthly, or even seasonal basis in tandem with international prices. The GOE could choose to tax fertilizer exports when international prices rise outside a band around their long-term trend levels and subsidize the factories directly when export parity prices are below the price band. Such a "buffer fund" approach would provide stable supplies of fertilizer for domestic use at appropriate but less variable economic prices, and avoid large seasonal and annual price swings. It would not be costly to operate as long as farmers pay prices equivalent to long-term export values. However, this example is not meant as a specific policy proposal but rather as an example of the need to develop new policy approaches and institutional arrangements to address issues of international price instability in cost-effective ways not disruptive of private sector trade.

RECOMMENDATION: The liberalization of agricultural production and markets should be completed and sustained. Under the APRP, attention is needed to a broader set of policy issues affecting the sector: enhancing the macroeconomic and trade policy environment; providing public services needed to make agricultural markets work better; encouraging private investment, competition and efficiency in agricultural input supply, processing, marketing, food distribution and trade industries.

RECOMMENDATION: Higher priority should be given to strengthening support services and designing institutional arrangements required for the market mechanism to function effectively and for intermediating between international and domestic markets. Cost-effective approaches are needed to reduce risks to national food security from high world prices of foods and fertilizer.

RECOMMENDATION: The GOE should strive to establish credibility and maintain continuity in its policy reforms, so that private sector agents both understand its policies and have confidence that they will not be reversed. Public interventions to offset perceived market failures should be designed, implemented and terminated in a timely and transparent manner so that operations in the private sector are disrupted as little as possible.

4.3 The Tranche Benchmark Monitoring and Verification Process

This has been one of the most successful aspects of the APCP project. The first tranche of the program assistance, disbursed in July 1987, only required issuance of several ministerial decrees to implement limited reform measures and memoranda to the USAID stating intentions to effect further reforms. Such ministerial actions were readily verifiable. The Tranche II benchmarks involved a larger and more complex set of policy actions and supporting activities such as studies, a pattern that was continued and expanded throughout the APCP period.

The responsibility for monitoring and verifying completion of the Tranche II benchmarks was assigned to the MALR's Undersecretariat for Agricultural Economics and Statistics (U/AES). Teams involving Undersecretariat personnel and outside Egyptian and expatriate consultants were formed to carry our verification activities and prepare reports on completion of the tranche benchmarks. The USAID evaluated the tranche report, balancing performance deficiencies on some benchmarks with better-than-required performance on others and approved the full tranche disbursement.

This process was repeated for Tranche III. The U/AES continued to have responsibility for monitoring and verification and planned and executed the necessary surveys and studies, using extensive Egyptian and expatriate assistance. A consultant was responsible for drafting the verification report, which became the operational approach for the rest of the project. The results were also discussed at a public conference.

The monitoring and verification for Tranche IV was supposed to be done under a separate project working in agricultural policy analysis. Problems arose in organizing the work under that project. The responsibility was returned to the U/AES with funding from the APCP late in the tranche period, and a consultant was assigned to assist in preparation of the tranche report. Due to the late start, the quality of the report suffered. However, for Tranches V through VII, the MALR Economics and Statistics Administration developed a monitoring and verification plan at the beginning of each tranche period and organized teams to monitor and verify the various benchmarks. Then a consultant drafted reports on each tranche for submission to the USAID by the MALR. These reports were very thorough in verifying the degree of completion of all benchmarks in each tranche.

Throughout the verification process, great concern has been exercised to ascertain that knowledge of policy changes actually arrived at the level of farmers and agribusiness enterprises (state-owned and private) so that decisions could be made based on the new policies. This verification of the public dissemination of policy actions could well be adopted in other programs as a means to strengthen the supply-side responses of the private sector to the policy changes.

The tranche monitoring and verification reports have been important not only to measure policy performance but also as sources of ideas and follow-up studies needed to modify benchmarks or formulate additional benchmarks for future tranches. This "feedback" function is essential for guiding specific tranche benchmarks over time toward the longer-term policy goals. It should be preserved in future policy programs. Indeed, more emphasis in the tranche reports should go to evaluating the benchmarks themselves, considering such questions as: Were the benchmarks the right ones to address the policy areas or issues? Did achieving the benchmarks lead to the expected improvements in policy? Is there need for related benchmarks in the next or later tranches to further address the particular policy issues?

RECOMMENDATION: A rigorous and timely benchmark monitoring and verification process should be continued as part of the APRP. Giving more attention to evaluation of the benchmarks themselves to determine what additional actions are required will help to guide the successive tranches toward fulfillment of the medium-term and long-term policy goals of the program.

4.4 Benchmark Formulation, Performance and Payments

Contrary to the situation in 1991 the MALR and USAID have since invested in a large number of studies to better understand policy needs and options within the sector and in the agribusiness industries. A list of these studies is provided as an annex. The completion of some of these studies has been required as tranche benchmarks.

Almost all of these studies have been undertaken by outside consultants, usually involving both Egyptian and expatriate experts. The process of preparing scopes of work, selecting consultants, reviewing reports and exercising quality control over the contents, has been exceedingly staff intensive for both the MALR and the USAID. Most of the studies have proven useful but not all were of uniform quality. Time and data constraints have been the main limitations. Such studies will continue to be needed to support future policy programs but a more efficient mechanism for their identification and execution could improve their average quality and usefulness.

Mention has already been made of the increase in the number and complexity of benchmarks in the later tranches under the APCP. As an example Tranche VII included 12 different benchmarks requiring performance in total of 38 identifiable areas. The benchmarks and sub-benchmarks ranged from studies and plans to specific policy actions. Careful and detailed assessment was made by USAID of performance in each one of the 38 areas, and the 12 benchmarks were equally weighted in arriving at an overall performance score. This score was then used to make a downward proportional adjustment in the planned cash transfer to the MALR.

While transparent, this procedure is perhaps too mechanistic. First, it treats the execution of studies and the formulation of plans and policy priorities on the same basis as actual policy reform actions. Furthermore, weighting an arbitrary number of sub-benchmarks equally within a given benchmark, and then weighting each of twelve benchmarks equally, is not very consistent with concepts of strategy and priorities, even if in that tranche multiple benchmarks happened to have given more weight to the more important policy issues.

An alternative approach that could be considered is to continue to organize each tranche into three sets of activities:

(1) Policy analysis and formulation studies
(2) Benchmark identification and specification activities
(3) Benchmark verification and evaluation

The first two activities would be carried out as part of the policy dialogue to ultimately identify specific benchmarks to be included in subsequent tranche agreements. The ministries and USAID would collaborate in these activities and *project assistance* would be provided to implement them. They would be reviewed and summarized in the tranche reports but would not enter into the evaluation of performance in relation to cash transfers.

Policy benchmarks in a given tranche would be limited to agreed policy reforms and actions to be implemented in the tranche period. To recognize the costs of implementation and adjustment to the new policies, some program assistance could be disbursed on a *non-conditional* basis at the beginning of a tranche period as a means to encourage implementation and to offset some of the expected adjustment costs for the ministries.

Conditional disbursement would be tied only to completion of the policy benchmarks themselves. With limited funds and a wide array of policy issues and areas involving several ministries, the issue of the relative importance of benchmarks in relation to cash transfers will become ever more complex. While it will always be difficult to assign priorities and rankings, improved sector models and continuing studies of policy impacts will gradually support more informed conclusions about ranking or grouping of benchmarks according to priority. Determination of relative importance will make it easier to provide conditional program assistance for benchmark completion more in proportion to the expected impacts of the individual benchmarks on, and significance for, the goals of the APRP. Continuing to weight all benchmarks equally and treating studies and benchmark formulation activities as equivalent to policy reform actions run the risk both of dissipating resources and of diminishing the incentive effects of the conditionality approach.

RECOMMENDATION: As part of the policy dialogue, project assistance should be used to finance studies and the analysis of policy options leading to the formulation of agreed policy benchmarks. Some program assistance should be disbursed non-conditionally to offset a portion of the costs of implementation and adjustment to the policy reforms. Conditional assistance should be attached only to policy reforms themselves and allocated in proportion to the expected impacts and strategic importance of the policy actions required by the various benchmarks in each tranche.

5.0 Institutional Strengthening Component

5.1 The Past and Future PBDAC

The Principal Bank for Development and Agricultural Credit (PBDAC)[5] has been a focal point for the economic reforms related to agriculture described in the preceding sections of this Assessment. The PBDAC, under the APCP, not only had a prime responsibility for seeing that the reforms were being carried out by various entities of the Government of Egypt related to agricultural policy but also went through dramatic changes in its organization as well as its role in agricultural development itself. As a motivational device, the APCP tranche benchmarks were negotiated between the PBDAC and the Ministry of Agriculture and Land Reform (MALR) on the GOE side, and the United States Agency for International Development as donor. As those benchmarks were fulfilled, funds were released in tranches to the Central Bank of Egypt. Equivalent amounts of funds in local currency were then transferred from the Government of Egypt to the PBDAC as equity capital. Largely as a result of these transfers, PBDAC's equity has risen from LE 100 million to LE 900 million[6] over the last ten years, which has put it in a much better position to support a larger loan portfolio.

The statements, observations and conclusions in this section should be seen not as criticisms of the PBDAC but rather in the context of the changes that have already occurred, and this Assessment's support for the PBDAC's continued progress toward becoming an increasingly effective intermediary for finance and credit throughout rural Egypt.

This subsection concentrates on the PBDAC as a bank and as the primary provider of credit and time deposit services in rural Egypt. For purposes of this assessment, "rural" areas of Egypt include fairly large cities and towns that are surrounded by agricultural production areas, but exclude the major metropolitan areas such as Cairo and Alexandria. Prior to the implementation of the APCP, the PBDAC provided credit as a portion of its overall activities. It was also responsible for distributing inputs and marketing outputs and, joint with MALR extension, for providing technology transfer to its clients in agricultural production. It was also carrying out a policing function of insuring that farmers were planting specified crops at specified times in specified areas, truly a daunting task for

[5] "PBDAC" refers not only to the central offices but also to the 20 affiliated BDACs, which are based at the governorate level, the 161 branch offices, the 950 village banks, and the 639 outlets, many of which are being converted from warehouses to bank offices.

[6] The transfer of dollars from USAID to the Central Bank, with equivalent transfers in LE to the PBDAC to support equity expansion, accounts for all of the equity growth, except for approximately LE 230 million that evolved from a reclassification of past due loans into current loans in 1994, which allowed the PBDAC to transfer funds from its reserve for bad debt into equity.

any organization. As reforms of the general economy of Egypt occurred, including reforms in the agricultural sector, by design and by agreement the PBDAC moved to being a more specialized provider of financial services. It is both necessary and desirable for the PBDAC to expand and improve its financial services; it is in the sole position to provide financial services to Egypt's people that live outside the urban areas as no other bank is in a position to provide those services.

With respect to the provision of credit *per se*, the PBDAC has gone through a dramatic transition. Both previous to and in the early years of APCP implementation, the PBDAC used a "cradle to grave" handling of the loans. Loans were extended "in kind", meaning that in most cases cash was not the medium of exchange on the loan. The borrower received items such as seeds, fertilizer, and even implements, as a part of the loan, and repayments were made through values of products sold back through the PBDAC warehousing/purchasing mechanism. Any cash that remained from the transaction was then given to the borrower. Past dues, as they are generally viewed by a formal financial institution, were nearly eliminated by this linked approach because of PBDAC's control of the entire transaction. At the same time, the PBDAC was often put in the position by governmental dictates to provide loans, loans in kind, or services such as pest control, at rates and prices that were not profitable for the Bank, thus keeping it in a weak financial position.

During the course of the APCP, both as a result of activities within the project itself and because of Egypt's progress in transition to a market economy as a whole, the role of the PBDAC changed from being primarily a "retail store" (in former Chairman Ezzi's words) to being a competitor within the banking sector of Egypt's economy, albeit with a particular market niche. The PBDAC is the primary provider of credit to the agricultural sector, and still maintains its position as the sole provider of formal agricultural production credit, particularly to the Egyptian farmers with small landholdings. No other bank in Egypt currently serves the smallholder agricultural producer, nor does there appear to be one that will in any near-term time horizon. The challenge is to be able to profit sufficiently from those financial services so that the PBDAC expands to meet the needs not only of its current clientele but also to be able to expand its banking services in the future. Table 5.1 gives a perspective on PBDAC's market share in agricultural financing compared to other formal financial institutions.

Table 5.1
Agricultural Lending by Formal Sources
and as a Proportion of Total Lending (1989-1994)
(LE millions)

	89/90	90/91	91/92	92/93	93/9.
Commercial Banks	968	1,227	965	1,183	1,206
Bus./Investment Banks	149	169	164	151	171
PBDAC	3,227	3,936	3,907	4,206	4,583
Total Ag. Lending	4,394	5,332	5,036	5,540	5,960
Total All Lending	**48,789**	**60,831**	**58,249**	**67,594**	**79,834**
Ag. as % of All Lending	9.0	8.8	8.6	8.2	7.5
PBDAC as % of Total Ag.	75.0	74.0	78.0	76.0	77.0
PBDAC as % of All Lending	6.8	6.5	6.7	6.23	5.78

Source: Central Bank of Egypt, as reported in "Strategic Priorities for Sustainable Agricultural Growth in Egypt: Impact on Growth and Employment", John Mellor, Datex Inc., November 1995

It appears from interviews with USAID and PBDAC personnel that the only agricultural lending that is being covered by the other banks is credit given to a few large agricultural producers, processors and exporters. The movement of some larger borrowers to more commercial sources has undoubtedly reduced some low-effort, high-return lending potential for the PBDAC, but it is certainly not negative for the economy as a whole for potential borrowers to be able to search for the best credit. However, PBDAC is, and will remain for the foreseeable future, the sole provider of formal finance for the smaller farmers and rural households of Egypt. This does not overlook the fact that there are informal sources of finance in the rural areas. The *gamayas*, or Egypt's version of the Rotating Savings and Credit Associations (ROSCAs), are found throughout the economy (including within the PBDAC structure itself) according to studies carried out under the APCP. Remittances from overseas employment, although difficult to quantify, are evident in rural areas, based on total remittances to Egypt through the formal banking system and as confirmed in interviews with rural residents. However, the PBDAC has and will continue to have its incredibly important role in providing formal finance in the rural areas.

The PBDAC is continuing to grow in nearly all respects of the provision of banking services in rural Egypt. Because of its growth in deposit mobilization, it has become less dependent on overdraft requirements from other banks (Table 5.2). Mobilizing deposits in the rural areas not only provides an important service to the clientele but also reduces the cost of funds for the PBDAC. At present, the PBDAC is paying an average rate of around 9 percent per annum for deposits, while overdraft funds cost around 12 percent.

Table 5.2
Credit, Deposits, and Overdraft Usage
(LE millions)

End of June	1989	1990	1991	1992	1993	1994	1995
Deposits	1,201	1,455	1,614	1,866	2,292	2,949	3,518
Overdrafts	1,400	1,340	1,691	1,628	933	764	375
Credit	2,726	3,277	3,936	3,907	4,205	4,583	5,608

Source: End of Tour Report: Dr. Mohamed Anwar Youssef, Finance/Capital Management Specialist, Chemonics, February 1996

The information presented above supports two major points: 1) The PBDAC has a crucial credit role that it is carrying out in rural Egypt, with a particular focus on agriculture; and 2) It is continuing to grow and evolve from an encompassing marketing and credit agency into a bank. That transition, however, is not yet complete.

The bank is still looking to expand its services, not in agricultural input distribution and marketing, but through more comprehensive credit provision in rural areas, not limited to agricultural producers and processors. There have been and are still ongoing debates within the PBDAC about which the ultimate lending client groups should be, but there appears to be movement towards a focus on the financial needs of the entire rural community. Although the Mission Statement (as of July 1993) shown below will undoubtedly be refined further over time, it does suggest how policy makers currently see the role of the PBDAC:

"The primary mission of the PBDAC and BDAC banking system is to provide a nationwide, long-term flow of development - supporting financial services to Egypt's rural people and agricultural sector. In implementing its primary mission the Bank expects to be financially viable; operate without government subsidy; marshall savings from rural clients as its major source of loanable funds; charge competitive interest rates or assess other charges at levels sufficient to cover operating costs, including expected losses; earn a reasonable profit; support Egypt's economic development policies; gain and retain the trust and confidence of Egypt's rural people; and encourage the rural people to use PBDAC and the BDACs as their principal lending and savings bank."

Even more succinctly, Mr. Kamal Khedr, the PBDAC's Vice Chairman and current APCP Executive Manager, when asked what vision he had for the PBDAC in the next five years, replied, "To be the best bank in Egypt!" The point of repeating this statement is to show that PBDAC's management does see a clear future for the bank not as an arm of government or a financier for the Ministry of Agriculture and Land Reclamation but as a serious player in the financial future of rural Egypt. The Mission Statement poses some serious issues to be dealt with in the future, but it does give a sense of how the bank sees itself continuing to evolve. The central issue is that for the PBDAC to ultimately achieve its stated goals, it will have to be able to operate at least as autonomously as other state-owned commercial banks, particularly with respect to issues like setting of interest rates, selection of clients, and obtaining capital, without being forced to provide services that do not result in positive income streams. This issue becomes increasingly important with the PBDAC's greatly expanded deposit base; it has fiduciary responsibility for protecting its depositors from losses.

RECOMMENDATION: The PBDAC should continue to focus on its provision of financial services to the rural areas of Egypt, with its long term financial viability as a primary goal. The lending should include all types of businesses that exist in rural Egypt, not only those that are directly related to agricultural production, processing, and marketing.

5.2 The Bank Improvement Program

There have been a large number of structural adjustments by the PBDAC over the course of the project, some of which have already been touched upon. It became evident, however, that clear models had to be established of what the PBDAC's system should look like in order to be more successful in the future. The promising model that is now being tested and refined is the Bank Improvement Program (BIP). Design work was carried out through 1994 and field implementation was initiated in early 1995[7], with a focus on one branch bank each in the Dakahleya, Beni Suef, and Gharbeya governorates, and two village banks for each of the three branches, a total of nine units. It has been conceptualized as "The basic strategy and targets for the Village Bank Improvement Pilot Program were (a) to provide creditworthy lending to a broader base of farmers and rural citizens, (b) to initiate an aggressive deposit mobilization program, (c) to improve PBDAC's banking support services, i.e., accrual accounting, and record keeping, (d) to design and install an employee bonus or incentive system based on unit profits and (e) to improve the bank's image, public relations,

[7] Beginning field activity for "bank improvement" during the last eighteen months of a ten year project appears to be late, but the focus of the APCP prior to that point in time had given more emphasis to agricultural policy reforms and improvement of overall PBDAC management capabilities.

physical facilities appearance, and customer service."[8] These elements, taken as a whole, can lead to success for the PBDAC as the main provider of financial services in rural Egypt.

Creditworthy lending. PBDAC has often been hampered by its own requirements for the standard instruments of collateral, primarily land titles. However, as has been shown by other programs in Egypt and throughout much of the rest of the world, reliance on collateral, especially with small loan amounts, is not the most valid criterion for judging creditworthiness. Rather it is the character of the borrower and the actual productive value of the loan usage that are the greater determinants of loan repayments. The same argument applies for loan usage. Within BIP, emphasis is certainly given to the rural areas, but the use of the loan can go beyond simple "agriculture and agriculturally related businesses" into the full range of other economic activities that are present in the rural Egyptian economy, irrespective of the actual nature of the business.

Including women as clients. The policy shift towards creditworthy lending rather than relying on land titles or other traditional instruments of collateral has particular implications for lending to women. For a long list of traditional and legal reasons, women generally do not have title to collateral, particularly land. The PBDAC deserves recognition in that it currently has about 462,000 women borrowers countrywide (as of December 31, 1995) with a reported 95.2 percent repayment rate. "WID[9] lending" started on a pilot basis in the Qalubia governorate on February 5, 1992. It was implemented in two village banks under APCP. Viewed as a success, the program was later expanded to all governorates. Six female trainers were sent for a six-week WID "training of trainers" program. The people receiving this training then had responsibility for training staff back in Egypt.[10] It is instructive to see the growth in lending to women in a single branch. In Beni Suef, women were recognized as having high growth potential as customers. In one year (April 95 to April 96), following orientation and training of the staff, the number of women customers grew from 386 to 1,438, reportedly with 95 percent on-time repayments. Loan amounts to women during that period grew from LE 208,000 to LE 719,000. Within that same time period, total credit outstanding of the Branch went from LE 193 million to LE 236 million, with only LE 88 million classified as agricultural credit.

Deposit Mobilization. It has been shown above that deposits can grow within rural areas. In the aggregate, the relatively poor can mobilize a large quantity of funds. The BIP has taken this potential to heart, and within the three areas, based on preliminary data, the units included within the pilot have shown deposit growth from 22 to 42 percent over 18 months. Based on the Chemonic's Consultant Nevine El Oraby's reports (confirmed during direct interviews for this Assessment), the data associated with deposit growth under BIP may be somewhat skewed because of some reported forced savings (where the borrower is enjoined to borrow additional funds that are then placed in a savings account) and some internal savings by employees (where a portion of salary

[8] End of Tour Report, Wilmot Averill, COP, Chemonics, Appendix A, Page A-5, April 1996.

[9] Women in Development.

[10] Information and data extracted from a USAID briefing document dated January 1996.

and bonus income is placed in an account shortly before the date when savings are measured). However, even with some of these temporary aberrations, it is clear that savings can be mobilized without undue effort by the Bank staff involved.[11]

The expansion of PBDAC's overall deposit base is impressive as well. Table 5.3 below gives a brief description of deposit growth from the baseline of June 30, 1989.

Table 5.3
Total Deposits in the PBDAC System

Date	Amount (LE billions)	Growth rate
June 89	1.17	
June 93	2.292	
June 94	2.949	28 percent
June 95	3.518	19 percent
June 96 (est.)	4.15	18 percent

Source: USAID Briefing Paper. April 1996, with data extracted from Chemonics Reports

Banking support services. The branches and village banks have utilized the improved and automated MIS that has been implemented under PBDAC to their advantage. They are utilizing a streamlined set of accounts that will give a more rapid and accurate picture of loan and deposit performance, having largely done away with the *fiche* (or customer information file) system of multiple categorization of loan usage. (The older system would break down a single loan of LE 1,000 into eight to ten sub-categories, tending to mask the performance of the loan as a whole.) By streamlining the recording procedures at the point of loan release (the village banks). the branch is in a far better position to view its overall portfolio performance.

Incentive system. PBDAC as a whole is still wrestling with improving its incentive system for employee performance. Where most employees of the PBDAC system can expect a year-end bonus of 14-22 times their monthly salary, the award of that bonus has been largely arbitrary in nature. The BIP is still looking to link incentives to performance of employees in such categories as deposit mobilization but has yet to find a formula to which employees will readily respond and that management feels it can sustain. This is still a challenge for the future of the program. Employee incentives based on performance of the loan and/or deposit portfolio, or related to the profit of the unit, are an element of nearly all successful small business finance programs worldwide. In an interview with Dr. Khedr, PBDAC Chairman , he stated that for the overall system the Bank is

[11] Deposit Mobilization Consultant Nevine El Oraby has also produced some excellent comparisons between PBDAC's current approach to lending and deposit mobilization with the systems currently being utilized in Malaysia and Indonesia, based on her training visit under the APCP.

currently trying to reduce the amount of subjective incentives and to slowly increase the incentives based on portfolio performance.

Bank image improvement. Bank image improvement stands on two legs: the improvement of physical characteristics of unit itself, and a reorientation of the unit's employees. The physical improvements are relatively easy to see; mostly they involve cleaning and painting the facility, and placing clear signs indicating that the entity is a bank. The attitudinal changes of the persons trained are almost as easy to detect. The main change in attitude, through training, is that employees treat clients as customers rather than as beneficiaries. Changes have included relatively aggressive outreach (going to the current or potential customers) as well as making customers feel welcome within the facility. To implement this sort of change nationwide will be difficult, but the pilot has certainly demonstrated that it is possible and productive.

In summary, the BIP has initiated promising directions for the future. It has begun to evolve a lending technology that can be successful, albeit still experiencing some problems, and senior managers indicated that they clearly see this approach to banking as the wave of the future for the PBDAC. The staff involved are committed to this future; if they can persevere and be supported by management they have a good chance of success. There is still some resistance expressed by some managers who apparently fear they do not have adequate control of their employees if the employees are not sitting in the bank but rather are out developing new business. This can probably be overcome only by these managers experiencing improved success in performance of their overall portfolio.

RECOMMENDATION: The PBDAC should continue to refine the methodologies being tested under the BIP with a long term view of utilizing the perfected model system wide. It could benefit from additional donor assistance to help it with the refinements in incentive systems and loan performance tracking, as well as providing training for staff, but by all means the PBDAC should continue and expand this effort.

5.3 Management Information Systems

The establishment of a computer-based Management Information System (MIS) is one of the obvious successes of the project, to the degree it was carried out. Before the implementation of the APCP, all systems were manual and reportedly it sometimes took over a year to complete a summary of bank performance.

Under the APCP, 46 PCS, 150 supermicros (covering nearly every branch), and 18 minicomputers (covering all governorates) were purchased, installed, and operators trained. Although data are still compiled manually at the village bank level, those data are then entered into computers at the branch level and subsequently are transferred by modem to the central office. This installation was carried out over six years, and is continuing to date while pushing the system down into selected village banks under the Bank Improvement Program.

The general functional areas covered, in order, were accounting (which allows computerized general ledgers to be produced), payroll, and deposits. Unfortunately, loan performance data was left for last. As a consequence, where general ledger data are concerned, the information, even at the central level, is quite timely, and largely operates as a standard routine. On the other hand, actual loan performance, such as the number of loans being paid on a timely basis, is still largely lacking, although some data are compiled within the "Credit Section" of the PBDAC, generally divided between "Agricultural Production" (LE 1.864 billion outstanding with LE 147 million past due) and "Investment" (LE 4.012 billion outstanding with LE 551 million past due).[12] Some of the more modern measures of loan performance, such as portfolio at risk, have not yet been utilized by PBDAC management. However, it was clearly stated by the data processing personnel that data supplied to management is being continuously reviewed and utilized, as shown by further information and more sophisticated data compilations requested by senior management. This utilization has improved greatly over the course of the project.

It should be noted that the MIS flow is almost entirely upward, *i.e.*, information flows to the central office, but analysis of that data is not provided back down through the system. The MIS department, as well as one governorate visited, clearly noted this one way flow of information. In fairness, the computerized system is used to issue directives back to the BDACs, but no analysis or comparisons with the nationwide system are carried out for the information of the units supplying the data. MIS programs only remain successful in the longer term if the people supplying the basic data in the first place have incentives to keep supplying it in a timely manner; comparative analyses returned to data suppliers serves a similar purpose as "thank you" letters, and help keep the data flowing upward.

RECOMMENDATION: The computerized MIS should be extended to fully capture loan portfolio performance and should include analyses of comparative performance that are then promptly returned to the governorate offices, the branch banks, and the village banks.

5.4 GOE Perception and Utilization of the PBDAC

The PBDAC has made great strides in revising and improving its image as a provider of financial services to the rural community over the course of the APCP. This is reflected both system-wide, such as the new mission statement, and on individual unit levels, such as where the Bank Improvement Program has been implemented. It is more problematic to change the government's perception of the bank, both at large and within the MALR. The PBDAC had acted for such a long time as a supplier of services at the will of the government that as it moves to act in a more fiscally responsible manner, there are bound to be conflicts over its role in the larger MALR/GOE context.

[12] This data is based on April 30,1996 internal reports of PBDAC, the figures cited are quoted from Makmoud Salah Gharib, Credit Section Head, during an interview on May 20, 1996, as a part of this Assessment.

An example of the PBDAC having to overcome this perception of being a cash window for the GOE was when an analysis showed that over LE 900 million was owed to the PBDAC by the Ministry of Finance. After protracted negotiations, and finally a lawsuit filed by the Bank, the government finally agreed to repay a portion of the amount owed. The PBDAC Chairman stated in an interview that about LE 500 million had been provided by a long term soft loan (6 percent per annum) from the National Investment Bank. The most recent consultant reports noted LE 100 million of direct payment from the Ministry of Finance as actually received by PBDAC.

This section of the Assessment will not dwell again on the events over the past year where the PBDAC, apparently through very little fault of its own, was instructed to again take up its previous role as a monopoly supplier of domestic fertilizer, a business that it had largely left. For a series of reasons related to exports of fertilizer by the major manufacturers (which are publicly-held), there was a spike in local prices due to shortages during the summer cropping season. The response of the GOE was to force PBDAC back to its old role and to take the subsequent heat from the international lenders and donors for having done so. The USAID and MALR, however, agreed upon clear benchmarks to terminate Tranche VII for the bank to retreat again to a residual role in the business, and it appears that the PBDAC will meet that withdrawal agreement. Such role reversions could happen again as long as the PBDAC still retains facilities and staff to handle input distribution.

RECOMMENDATION: The PBDAC should continue its efforts to be viewed by the GOE as a bank and not as a purveyor of subsidies, input distributor and supplier of marketing services. Complete divestiture of the facilities and personnel currently and previously utilized for input distribution would greatly assist the bank in changing its image, and make the problem of excess employees and facilities the responsibilities of the GOE/MALR.

5.5 Profitability

The GOE's perception of the PBDAC's role is frequently at odds with the organization's financial well being. The second sentence of PBDAC's recently revised Mission Statement states, "In implementing its primary mission the Bank expects to be financially viable; . . ."Over the past three years, even with divestiture of most of its marketing functions, the PBDAC has managed a modest total pre-tax profit of LE 47.8 million, as shown in Table 5.4.

Table 5.4
Profit Summary for Fiscal Years
(LE millions)

	1993	1994	1995
Declared Profits before Taxes	+84.7	+35.5	+- .4
Minus Prior Year's Revenue	-75.4	-69.1	-45.5
Plus Prior Year's Expenses	+39.5	+6.2	+23.8
Adjusted Profits before Taxes	+48.8	-27.4	+26.4

Source: Supplementary Report by Dr. Mohammed Anwar Youssef, Finance/Capital Management Specialist, Chemonics, November 1995

This profitability, however, is now being jeopardized by recent events, although the bank might even have some profit gains from its temporary re-entry into the fertilizer business. (This possible increase in income is undermined by the fact that the PBDAC was directed to provide domestic fertilizers on credit even to those farmers who had past due loans or bad debts with the Bank.) The cost squeeze that the PBDAC is in through a combination of deposit rates at or near the commercial banks (8.5-10.0 percent), but loan interest rates set by the GOE is described in the "Supplement" to the Tranche VII Report (31 March 1996, p. 83). "On 31 January 1996 the Council of Ministers passed a resolution to promote agricultural production and development in a variety of ways. One resolution calls for the reduction in the interest rates on PBDAC loans by 3 percent." The new rates, 11 to 13 percent (simple interest, per annum), have been acknowledged by the PBDAC management to be below PBDAC's cost of obtaining money plus operating costs. The overdraft rate at the time was 10-11 percent and the operating costs of the PBDAC were reported at 4 percent. Thus, any effective interest rates on loans below 14-15 percent would result in PBDAC losses.

Chairman Khedr announced the following interest rate structures in the local newspaper, Al Ahram Al Iktasadi, on March 11, 1996:

Short Term Crop Production	11 percent
Short Term Investment and Commercial Loans	12 percent
Medium and Long Term (>1 yr.,>10 years)	12 percent
Loans to Youth Projects	9 percent
Land Reclamation and Irrigation Improvement	6 percent
Beef Veal Production	9 percent
EC Supported Loans	11-12 percent

The consequence of this interest rate structure, however well-intentioned by the GOE, will be to drain some of the financial life out of the single entity that is in a position to provide credit to the small borrowers of rural Egypt. These combinations of borrowing and lending rates will not only reduce the PBDAC's ability to provide finance in real terms but in nominal terms as well. The stated interest rates of a bank, however, while generally the easiest factor for outsiders to focus on, are generally only a significant fraction of the borrower's total transaction costs in obtaining and repaying a loan. To the extent other fees are charged, the effective rate for borrowers are higher than the stated rates. In the longer term, the PBDAC will have to able to charge interest rates plus fees that allow it to at least break even. The short-term political gains that might be made through lower cost credit will severely hamper the bank's long term financial viability. In the long run, if the PBDAC is to become more autonomous from governmental intervention in such crucial areas as interest rate setting, it will have to free itself from being perceived as an agent of government. The PBDAC, based on its expanded deposit base, is now able to present an argument to the various government entities that it cannot lend unprofitably and still protect the security of its many small depositors.

RECOMMENDATION: The PBDAC should continue its efforts to focus on its profitability by expanding its deposit base and by seeking ways to establish its autonomy so that it can maintain its long term viability without undue government intervention, especially with regard to effective interest rates charged to borrowers.

5.6 Workforce Reduction

Related to the PBDAC's cost of operations is the issue of the number of employees it still retains. A clear benchmark included in Tranche VII of the APCP was to reduce the number of employees by 5,400, or to a total workforce of around 29,000 employees. In fact, 4,771 (88 percent of the target) employees either did not have their contracts renewed, retired, or opted for early retirement. At this point, PBDAC came head-to-head with some of the labor laws and Presidential announcements that no one should lose his job as a result of the move to a market economy. There are currently attempts to retrain workers and absorb them in expanded banking activities, and to move people that had been working with the warehousing function of the PBDAC into private business.

Even though it appears that the PBDAC has made serious efforts to reduce staff, its costs of payroll have actually gone up over the past three years, as has its ratio of administrative costs to performing loans (Table 5.5).

Table 5.5
Payroll Costs and Administrative Cost Ratio
(LE millions)

	1993	1994	1995
Payroll Costs	271.0	287.8	313.6
Ratio of Administrative Costs to Monthly Avg. of Performing Loans	4.33%	4.45%	5.42%

Source: Extracted from PBDAC/Chemonics Reports

One possible explanation for these anomalies is payouts for early retirement, but that does not precisely explain how total staff can be reduced and payroll expenses continue to climb. The PBDAC, as a government agency, is also forced to raise salaries on an annual basis, (usually at least 10 percent); consequently, it may reduce staff while total payrolls still rise.

RECOMMENDATION: The PBDAC should continue to explore methods for staff reduction beyond natural attrition. The methods might include increased opportunities for staff to enter the private sector with financing of activities such as warehousing/retail input sales. The Bank might also negotiate with the MALR to absorb staff that are redundant to the PBDAC as a financial institution, some of whom could possibly be retrained as MALR extension workers.

5.7 Considerations for the Future of the PBDAC

The first decision that a government must make, especially in an era of divestiture, is whether or not it wishes to continue its ownership of an entity. It does not appear that there are any compelling reasons to simply "do away with" the PBDAC. It is playing a crucial, albeit altered, role in support of Egypt's agricultural sector, and is at least partially serving the needs of around 3.5 million customers in rural Egypt. It currently has an equity in excess of LE 900 million, and a great deal of money and effort have gone into improving the bank to the state it is in at present. However, in order to survive and prosper so that it can serve its borrowers' needs even better, further structural changes will have to occur if the GOE and donors wish to avoid subsidies in the future.

Commercial bank status. One possibility is that PBDAC move to a status equivalent to the Egyptian commercial banks. As such, it would continue to be state-owned but would have autonomy to operate competitively within the banking system and under the same supervision and prudential regulation as the commercial banks. The problems with this approach are that it would require a major institutional change in PBDAC's organization and that servicing PBDAC's millions of small borrowers and depositors would make it difficult for PBDAC to operate profitably within Egypt's highly competitive banking system. The PBDAC would also need to be given a charter to offer a full range of financial services including current deposits.

Development bank mode. The PBDAC's long-term survival will depend on its operating more on commercial (profitable) terms, and this will have to include it evolving a character that is somewhat more autonomous, although still supportive of political interventions in Egypt's agricultural sector. An approach utilized in many other countries with a similar structure of a large portion of agricultural production carried out by farmers with relatively small land holdings is to establish a development bank, a development bank, nevertheless, that has the capability to operate with cost centers. Certain costs that might have to be borne by the bank (but can be supported by the government and/or donors), such as research and development and high-risk lending that might not be profitable, are set aside as clear costs. On the other hand, profitable operations, such as lending to small and micro enterprises, including agricultural production, are isolated in such a fashion that their cost and returns can be carefully measured.

As an example, if the cost of lending for loans to owners of one feddan or less (probably 50 percent of current PBDAC borrowers have less than one feddan) is 16 percent per annum, a slightly higher rate can be set to allow for growth of credit in real terms. At the same time, if the cost of lending for agricultural processing appears to be somewhat less, a lower interest rate can be charged as long as the loans result in profitable operations for the bank. Having said this, a plethora of loan programs, with a vast number of sub-categories defined by the various types of fruits, vegetables, cereals, and livestock production in Egypt, is not envisioned but rather a systematic approach to lending to various client groups in rural areas based on costs and returns to the bank for servicing each group of borrowers.

The role of the PBDAC has to be more fully converted from where it is a "channeling bank", where government resources and dictates are translated into targeted lending for purposes such as "veal production", into being an "executing bank". An executing bank, even though it might utilize outside resources, is still wholly autonomous in borrower selection, supervision, and collection. It all cases, an executing bank takes responsibility for borrower selection, irrespective of the type of business that is financed.

In order to successfully carry out a conversion of the Bank to operating more on commercial terms, there needs to be a further injection of experienced bank management into the PBDAC. Although PBDAC's management is clearly dedicated to providing banking services, there is still a lack of adequate professional training and experience with modern banking techniques. Various methods have been proposed by consultants under the APCP; one of the most promising would be a "pairing" arrangement where outside professionals would work directly with existing staff for a period of time to pass on the skills. While there might be some need for expatriates experienced in successful small and microenterprise programs in other countries, Egypt has a broad range of highly competent bankers within the public and private sectors, some of whom might be currently working abroad but could be lured home by the prospect of assisting the PBDAC to meet its long-term objective of "providing a nationwide, long-term flow of development-supporting financial services to Egypt's rural people and agricultural sector."

This possibility of further technical assistance should be tempered by the experience under the APCP, where counterparts were often not clearly designated until the last two years of the project. If further technical assistance is to be utilized by the PBDAC, clear relationships between the consultants and the PBDAC staff should be established from the initiation of the assistance.

RECOMMENDATION: The PBDAC should utilize foreign but particularly domestic banking expertise to continue to upgrade the skills of its management and staff.

5.8 Structural Reorganization

The PBDAC, as has been noted, has been making progress in terms of its management. One of these issues is related to raising the loan approval authority of the branches and village banks. On 2 February 1995, the village banks had their loan approval limits raised from LE 20,000 to 40,000 (in November 1995, up to LE 50,000), and the branches had their authority raised from 50,000-60,000 up to 100,000-120,000, at least a 100 percent increase for both. A limited number of branches later had their authority limit raised to LE 150,000. These actions are strong support for the banking system becoming more decentralized. However, the structure of the bank could certainly be further streamlined. A system that evolved to provide nationwide agricultural input supply and marketing services is not necessarily a structure that can most efficiently provide financial services. Rather than having 17 governorate based banks (BDACs) with their accompanying Boards of Directors, support staff and other costs, regional BDACs could be formed (say 6-8) which could monitor the branches and village banks in several governorates just as effectively and with a lesser number of senior managers and administrative staff.[13] PBDAC's Chairman Khedr realizes that this reduction in BDAC's would mean a loss in status for some of the BDAC chairmen and senior managers, but in the longer term it should lead to greater efficiencies within the overall PBDAC system. This sort of reorganization would also demand greater professionalization of the smaller staff, lending more urgency to the recommendation in the previous subsection.

The Chemonics' consultants also recommended a managerial restructuring that merits serious consideration. The PBDAC chairman has a prestigious and demanding external policy role representing the financial and policy interests of agriculture before national policy makers and political and legislative bodies, as well as frequent need to represent the PBDAC, the MALR and the GOE internationally. Within the Bank, functioning as Chairman of the Board of Directors would provide a logical approach for fusing the Chairman's external and internal policy roles. The

[13] The National Bank for Development has recently carried out this type of restructuring in accordance with the Basel Accords. It now has four regional districts rather than the 20-plus individual banks it previously had.

Chairman, with the approval of the Board, would establish PBDAC-wide policies and monitor the overall performance of the Bank. Internal operational management dedicated to carrying out the policies and meeting the performance objectives set by the Chairman and the Board, would be the responsibility of a Chief Executive Officer (CEO), who would devote full-time to internal bank management responsibilities. This division of responsibility between a Chairman's external and internal policy roles and an operating CEO role exists in many successful large corporate organizations.

RECOMMENDATION: The PBDAC should rationalize the organizational structure of the BDAC system for greater efficiency by reducing the number of BDACs.

RECOMMENDATION: The PBDAC should move toward a senior management structure that differentiates the external and internal policy roles of its Chairman from the operational bank management responsibilities of a Chief Executive Officer.

5.9 Technical Services and Training

Chemonics International provided over $25 million of technical services over the course of APCP implementation. As stated elsewhere in this Assessment, the contractor had to perform in a very dynamic atmosphere of structural and policy changes occurring not only within PBDAC, but in Egyptian agriculture and the economy as a whole. While it would be difficult to link specific changes within the Bank to specific technical services, it appears that the institutional strengthening tasks were generally achieved. The contractor, as evidenced in the annual work plans, followed up on the tasks to be carried out in exacting detail, including when recommendations or policy papers were required, but then these recommendations were not always responded to or acted upon by the PBDAC. It appears that all services required by the contract were provided; there are still questions as to what PBDAC's ability was to effectively use the services and information provided, given its existential situation in regard to MALR/GOE interventions.

Interviews with the PBDAC management invariably included references to individuals involved in the delivery of technical assistance. While there were periodically some personality conflicts, it is clear that to a degree skills were transferred. The informal interchanges between experts of an on-site contractor and a fairly stable bank staff cannot be quantified but were surely present. It does appear that earlier and more continuous direct linking of consultants with identified counterparts would have yielded even better results. The formal training that was carried out under the project, given the relatively low skill levels within the Bank, apparently has had a long-lasting effect. The formal training under the APCP appears to have equaled or exceeded targets (Table 5.6).

Table 5.6
Formal Training Provided Under APCP
Number of Trainees

	Life of Project Planned	Life of Project Achieved
Domestic Training	9,500	23,400
Off-shore Training	200	210

Source: Internal USAID Report, April 1996

6.0 Summary of Recommendations

The recommendations made in the text of the Assessment are summarized in this section. The recommendations are grouped according to the policy reform and institutional strengthening components of the APCP. Especially within each component, the recommendations should not be viewed as separate and independent: each recommendation has implications for, and relationships to, other recommendations in the same section.

6.1 Policy Reform Recommendations

- USAID and the GOE should determine how the new APRP sectoral program assistance can be utilized effectively within a multi-ministerial framework so that the local currency generated creates incentives for implementation of agreed reforms, alleviates costs of adjustment, and encourages sustainable sectoral capacity-building and institutional improvement.

- The MALR should identify and implement innovative approaches to improve the capacity of extension to successfully deliver research-based technological and managerial information to Egypt's millions of small farmers. The PBDAC should coordinate its lending with the flow of information, but not be responsible for the transfer of technology.

- The APCP process of establishing longer-term policy goals and then formulating specific policy actions in a sequence of tranche agreements to reach those goals should be continued in the new APRP and adopted in other USAID policy reform programs.

- The new APRP should complete and sustain liberalization within the sector but also address a broader array of policy issues affecting the sector, including the macroeconomic and trade policy environment; public services and institutional arrangements to improve market performance; and constraints on private investment, competition and efficiency in agribusiness industries. food distribution and trade.

- High priority should be given to identifying public services and institutional arrangements needed to improve domestic price discovery and intermediate between international and domestic markets. Cost-effective mechanisms should be devised to protect national food security in the face of fluctuating and high world prices for foods and fertilizers.

- The GOE should strive to establish credibility of its policies through continuity and stability in order to enhance public confidence, and transparency in the design, implementation and termination of responses to market failures and shocks.

- The APRP should continue the tranche monitoring and verification process, giving more emphasis to evaluation of the benchmarks and identification of additional policy actions needed to resolve the policy problem or issue addressed by particular benchmarks.

- Program and complementary project assistance should be used to support collaborative studies and benchmark formulation activities, non-conditional assistance to offset costs of implementation and adjustment, and conditional assistance proportional to the strategic importance and expected impacts of agreed reforms within a given tranche.

6.2 Institutional Strengthening Recommendations

- The PBDAC should continue to focus on provision of financial services to the rural areas of Egypt, with long term financial viability as a primary goal. The lending should include all types of businesses that exist in rural Egypt, not just those directly related to agricultural production, processing, and marketing.

- The PBDAC should continue to refine the methodologies being tested under the BIP with a long term view of utilizing the perfected model nationwide. It would benefit from additional donor assistance to help it with the refinements in incentive systems and loan performance tracking, as well as providing training for staff. But in any event, the PBDAC should continue and expand this effort.

- The computerized MIS should be extended to fully capture loan portfolio performance and should include analysis of performance that is then returned to the BDACs, the branch banks, and the village banks.

- The PBDAC should continue its efforts to be viewed by the GOE as a bank and not a purveyor of technical assistance, marketing services and subsidies. Complete divestiture of the facilities and employees currently and previously utilized for input distribution and marketing would greatly assist the bank in changing its image.

- The PBDAC should continue its efforts to focus on its profitability by expanding its deposit base and possibly seek ways to broaden its ownership base so that it can maintain its long term viability without undue government intervention.

- The PBDAC should continue to explore methods of staff reduction beyond natural attrition. The methods might include increased opportunities for staff to enter the private sector with financing of activities such as warehousing/retail input sales. It should also negotiate with the MALR to absorb staff and facilities that are redundant to the PBDAC as a financial institution.

- The PBDAC should utilize both foreign and particularly domestic banking expertise to upgrade the skills of its management and staff.

- The PBDAC should reorganize its management structure and the BDAC system for greater efficiency. A Chairman/CEO structure for senior management and a reduction in the number of the BDACs should be implemented.

Annex A

List of analytical studies of agricultural policies carried out by the Ministry of Agriculture and Land Reclamation, with funding and technical assistance from the United States Agency for International Development, during 1992 - 1996. These studies are available in the Office of Agricultural Credit and Economics, Directorate of Agriculture, U.S. Agency for International Development, Cairo, Egypt.

Policy Impact Studies

1. An Assessment of the Potential for Liberalization of the Cotton Production, Trade and Ginning Sector
2. Impacts of Agricultural Policy Reforms on Rice Production, Milling, Marketing, and Trade in Egypt; Update (1995) Analysis of Egypt's Rice Marketing System
3. Fertilizer Policy Impact Study
4. Animal Protein Foods System: Increasing Efficiency of Production, Processing and Marketing
5. Potential for Short Season Cotton Production in Egypt
6. Maintaining Food Security in Egypt During and After Agricultural and Food Policy Reform

Assessment of Policy Issues

1. Analysis of Horticultural Trade in the European Market: Implications for the Near East
2. Policy and Regulatory Environment of Agricultural Input and Output Markets: Their Evolution and Responses of Private Traders to Policy Changes
3. Policies Affecting Agribusiness in Egypt: A Comprehensive Assessment using the Agribusiness Policy Inventory Method
4. Strategic Priorities for Sustainable Agricultural Growth in Egypt: Impact on Growth, Employment, Trade and Privatization

Subsector Studies

1. Assessment of Potential for Liberalization and Privatization of the Egypt Cotton Textile Subsector
2. New Lands Development Study
3. Irrigation Water Cost Recovery in Egypt: Determination of Irrigation Water Costs
4. Assessment of Fertilizer Supply and Potential for Liberalization and Privatization of Fertilizer Production
5. Strategic Research Program: National Center for Water Research, Egypt
6. Agricultural Cooperative Assessment for Egypt

Annex B

PBDAC Management Structure

Year	Name	Position
1986-5/1993	Mr. Adel Hussein Ezzi	Chairman & APCP General Manager
	Mr. Mahmoud Noor	Vice Chairman & APCP Ex. Manager
	Mr. Kamal Nasser	Sector Head & APCP Ex. Manager
5/1993	Dr. Hassan Ali Khedr	Chairman & APCP General Manager
	Mr. Noor & Mr. Nasser	Remain as Executive Managers
8/1993-3/1996	Eng. Zeinab Salem	Vice Chairman and APCP Ex. Manager (Replacing Mr. Noor)
5/1994	General Ahmed Regei El Maraghy	Vice Chairman and APCP Ex. Manager (Replacing Mr. Nasser)
1995	Mr. Salama Ghobashi	Vice Chairman and APCP Ex. Manager (Replacing Mr. Maraghy)
3/1996	Mr. Kamal Khedr	Vice Chairman & APCP Ex. Manager (Replacing Eng. Zeinab)

Annex C

Persons Contacted

Samir M. Sultan	Training/Bank Image Improvement Advisor, Chemonics
Abdel-Hamid Mohamed	Banking Systems Specialist, Chemonics
Mohamed el Bagoury	Banking Operation Specialist, Chemonics
Doug Petrie	Admin/Management Specialist, Chemonics
Hatem Kalifa	Local MIS Specialist, ArabSoft
Wilmot Averill	**Private Sector Specialist and International Chief of Party, Chemonics**
Ebtesam Kabil	General Manager, PBDAC (And Manager of Bank Improvement Program)
Nivine El Oraby	Marketing Specialist, Chemonics
Mohamed Anwar Youssef	Finance/Capital Management Specialist, Chemonics
Minar Bassiouni	Technical Researcher and Implementation Coordinator. Chemonics
Nahed Iskandar	Office Manager, Chemonics
Clemence Weber	Associate Director, AGR, USAID
Ali Kamel	Project Officer, USAID
David Alverson	Office Director, ACE/AGR USAID
Fenton Sands	Agricultural Economist, ACE, USAID
Rollo Ehrich	Senior Economist, ACE, USAID
Mohamed Omran	Agricultural Economist, AGR/ACE, USAID
Paul Mulligan	Economist, EAP Directorate, USAID

Randall Parks	Evaluation Officer, USAID
Adel Hussein Ezzi	Chairman, El Watany Bank (and former PBDAC Chairman and APCP General Manager)
H. E. Ahmed Goueli	Minister of Trade and Supply, GOE
Mr. Mahmoud Noor	Former Vice-Chairman and Executive Manager, PBDAC; Coordinator PPR
Mr. Kamel Nasser	Former Sector Head, PBDAC and former APCP Executive Manager
Dr. Hassan Ali Khedr	Chairman, PBDAC (and APCP General Manager)
Dr. Saad Nassar	Director, Agricultural Research Center and Supervisor for Economics and Statistics, MALR
Eng. Zeinab Salam	Vice Chairman, PBDAC (and former APCP Executive Manager)
Mr. Kamal Khedr	Vice Chairman, PBDAC (and APCP Executive Manager)
Mr. Ramadan	Chairman, BDAC Beni Suef
Mr. Adel Aly El Sherif	General Manager, Data processing, PBDAC
Mr. Al Gharib	Head, Credit Section, PBDAC

Annex D

Statement of Work

Similar to the APCP Midterm Evaluation, the contractor shall address and update implementation progress related to the following key concerns:

A. How adequate and effective have the APCP organizational and management structures been in supporting implementation to achieve the project goal and purpose and produce outputs by the PACD?

Have the planning, programming and budget processes been adequate to ensure that consultants, equipment and participants are being properly and effectively utilized? Have the project's monitoring and information systems produced sufficiently quantitative, accurate, relevant, and timely data to satisfy the information needs of Bank Management, TA contractors, and USAID project management regarding banking functions, financial reporting, implementation progress and project impact? Have sector heads and BDAC chairmen been effectively utilized by the PBDAC project director's office? Has the Chemonics team and the Chemonics home office provided adequate intellectual leadership and implementation support? Have the development resources, project management assistance, and guidance provided by USAID been appropriate and sufficient? Has the budgetary support for the project been adequate and timely? Has PBDAC/BDAC staffing been adequate? (Have sufficient counterpart and local staff been in place?) Has the PBDAC policy and decision-making process been strengthened? Have linkages been developed to senior decision makers? Has coordination and integration between APCP and other USAID projects and other donors who have responsibility for institutional strengthening of banking functions been productive and timely?

The team shall:

1. Determine whether the overall management, organization, focus and implementation progress to date has been appropriate, coordinated, and functioning to achieve project objective by PACD.

2. Make specific recommendations for improvements, if and where warranted.

3. Assess the extent to which recommendations identified in the baseline study and the midterm evaluation have been addressed.

B. Has the technical assistance contractor effectively designed and implemented Credit Development, Banking Systems, Training, and Program Support Services to enhance PBDAC's institutional capacity?

Has the village bank improvement program and the strategic planning process been successful to date? What are the prospects for instituting a formalized strategic planning process within the Bank by the PACD?

The team shall:

1. Review specific project activities, comparing actual progress to workplan goals to determine whether: implementation progress has been satisfactory; PBDAC has been strengthened as a direct result of the activity; the professional training (in-service and participant) has been timely and relevant; needs and constraints of beneficiary groups, including women, have been adequately addressed; the implementation process has resulted in institutionalization of improved systems and procedures throughout PBDAC sectors and BDACs; participation by Bank staff has been sufficient to ensure that systems will be sustained after project completion.

2. Examine the APCP training plans to determine and assess whether they have been clearly based on institutional needs, and that they satisfy the requirements of Handbook 10 and Mission Order 10-1.

3. Make specific recommendations for improvement, if and where warranted.

4. Assess the extent to which recommendations identified in the baseline study and the midterm evaluation have been addressed.

C. What impacts has the project had on farmers and on PBDAC's institutional capacity and financial viability?

Are there indications that agricultural investment has increased as a result of the project? Has there been an overall increase in agricultural productivity and farm incomes as a result of the project? What progress has been made toward improving banking procedures in the village banks? Have transaction times been reduced, borrowing procedures simplified? Have the number and LE value of unsubsidized crop loans increased since the beginning of the project? Is PBDAC improving its financial viability as measured by standard indicators for credit institutions? What percent of PBDAC lending is at the highest legal rate?

By how much has PBDAC's capitalization increased? How much of the increase is attributable to annual performance disbursements over the LOP, increased contributions from the Treasury, increased retained earnings? Have the efficiency and the cost of banking and credit operations been improved? What progress has been made toward developing and implementing policies to increase private business involvement in input supply and decrease PBDAC's input distribution functions? What difficulties and constraints to such policy change have been encountered and how might they be remedied?

The team shall:

1. To the extent possible using data generated by project monitoring and reporting systems describe, in as quantitative terms as possible, the project's impact on farmers and on PBDAC's institutional capacity and financial viability.

2. Assess the likelihood that desired impacts will be achieved by PACD. Make specific recommendations for enhancing impact, where warranted.

3. Based on the foregoing analysis, make recommendations for improving the usefulness of impact data collected by the Bank's monitoring systems.

4. Assess extent to which recommendations identified in the baseline study and the midterm evaluation have been addressed.

D. Are there aspects of the design and operation of the policy reform element which would be modified to improve their effectiveness?

Has conditionality of disbursement provided a sufficient incentive for policy reform? Are there ways performance might be improved? Has the process of identifying policy objectives and benchmarks and verifying progress been satisfactory? Have past negotiations and project monitoring resulted in adequate initial commitment and/or follow-up action by the key decision makers? Has the mix and amount of resources devoted to monitoring already agreed-upon actions and designing future reforms been appropriate? Would it be advisable for the ministry to take a stronger and more leading role in the preliminary analysis and design of future policy reforms? Have the expected nature and distribution of socioeconomic, political, and institutional impacts of proposed reforms been adequately analyzed and have the results of these analytical studies been used effectively to promote policy changes? Is this policy reform model likely to be adaptable for use in other sectors in Egypt or other AID-assisted countries?

The team shall:

1. Review and analyze the design, operation and impacts of the policy reform element and, if warranted, make recommendations for modification.

2. make recommendations regarding the applicability of this performance-based disbursement model, or adaptations of it, to other sectors in Egypt or to other AID-assisted countries.

3. Assess extent to which recommendations identified in the baseline study and the midterm evaluation have been addressed.